

"(i) an election under subparagraph (B)(ii) to be treated as a qualified subchapter S subsidiary, or
"(ii) an election under section 1362(a) to be treated as an S corporation.

before its 5th taxable year which begins after the 1st taxable year for which such termination was effective, unless the Secretary consents to such election."

(c) CERTAIN DIVIDENDS NOT TREATED AS PASSIVE INVESTMENT INCOME.—Paragraph (3) of section 1362(d) is amended by adding at the end the following new subparagraph:

"(F) TREATMENT OF CERTAIN DIVIDENDS.—If an S corporation holds stock in a C corporation meeting the requirements of section 1504(a)(2), the term passive investment income shall not include dividends from such C corporation to the extent such dividends are attributable to the earnings and profits of such C corporation derived from the active conduct of a trade or business/".

(d) CONFORMING AMENDMENTS.—
(1) Subsection (c) of section 1361 is amended by striking paragraph (6).

(2) Subsection (b) of section 1504 (defining includible corporation) is amended by adding at the end the following new paragraph:

"(8) An S corporation."

SEC. 1309. TREATMENT OF DISTRIBUTIONS DURING LOSS YEARS.

(a) ADJUSTMENTS FOR DISTRIBUTIONS TAKEN INTO ACCOUNT BEFORE LOSSES.—

(3) Subparagraph (A) of section 1366(d)(1) (relating to losses and deductions cannot exceed shareholder's basis in stock and debt) is amended by striking "paragraph (1)" and inserting "paragraphs (1) and (2)(A)".

(4) Subsection (d) of section 1368 (relating to certain adjustments taken into account) is amended by adding at the end the following new flush sentence:

"In the case of any distribution made during any taxable year, the adjusted basis of the stock shall be determined with regard to the adjustments provided in paragraph (1) of section 1367(a) for the taxable year."

(b) ACCUMULATED ADJUSTMENTS ACCOUNT.—Paragraph (1) of section 1368(e) (relating to accumulated adjustments account) is amended by adding at the end the following new subparagraph:

"(C) NET LOSS FOR YEAR DISREGARDED.—
"(i) IN GENERAL.—In applying this section to distribu-

tions made during any taxable year, the amount in the accumulated adjustments account as of the close of such taxable year shall be determined without regard to any net negative adjustment for such taxable year.

"(ii) NET NEGATIVE ADJUSTMENT.—For purposes of clause (i), the term net negative adjustment*

means.
respect to any taxable year, the excess (if any) with
of—

"(I) the reductions in the account for the taxable
year (other than for distributions) over

"(II) the increases in such account for such taxable
year."

(c) CONFORMING AMENDMENTS.—Subparagraph (A) of section
1368(e)(l) is amended—